Attachment 5

Statutory Accounting Principles (E) Working Group
May 24, 2022 – Interim Call
Comment Letters Received

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May 6, 2022

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

RE: Items Exposed for Comment by the Statutory Accounting Principles Working Group on April 4, 2022, with Comments due May 6th.

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the exposure drafts released for comment by the NAIC Statutory Accounting Principles (E) Working Group (the Working Group) during its meeting on April 4 in Kansas City.

We offer the following comments:

Ref #2019-21: Proposed Bond Definition

Pursuant to the direction from the Working Group in October 2020, a small group of regulators and industry have been meeting regularly to draft a bond definition for consideration. The intent of this project is to clarify what should be considered a bond (whether captured in SSAP No. 26R—*Bonds* or SSAP No. 43R—*Loan-Backed and Structured Securities*) and reported on Schedule D-1: Long-Term Bonds. This exposure is specific to the proposed bond definition included in the exposed Form A, along with the glossary (page 5) and appendices (pages 6-12), but comments on future developments (such as reporting changes, accounting and reporting guidance for items that do not qualify as bonds, transition guidance, etc.) may also be submitted to assist in the development of these items.

Interested parties are providing comments in a separate letter for this item due to the number of issues involved.

Ref #2022-03: ***Premium Adjustments Allocated to Jurisdictions***

The Working Group moved this item to the active listing and exposed proposed revisions to be incorporated into a Blanks (E) Working Group proposal (2022-10BWG) which would modify the instructions for Schedule T, the State Page and Accident and Health Policy Experience Exhibit (AHPEE). The proposed revisions clarify that all premium adjustments shall be allocated as premium in each respective jurisdiction. This agenda item did not propose statutory revisions. This item was exposed with a shortened comment period ending May 6 to permit consideration for a year-end 2022 effective date of the reporting revisions.

Interested parties have no comment on this item.

Ref #2022-08: ***Treatment of Freddie Mac WI Certificates***

The Working Group moved this agenda item to the active listing and exposed a tentative interpretation INT 22-01: Freddie Mac When-Issued K-Deal (I Trust) Certificates to clarify that investments in the Freddie Mac "When Issued K-Deal" (WI) Program are in scope of SSAP No. 43R. This item has a shortened comment deadline of May 6.

Interested parties support the conclusions reached on this interpretation.

Ref #2021-21: ***Related Party Reporting***

The Working Group exposed this agenda item, incorporating proposed revisions after considering comments from interested parties shown highlighted in gray below. The changes from the prior exposure only clarify previous components of the proposed revisions. Similar changes to the blanks proposal are also concurrently exposed by the Blanks (E) Working Group in their corresponding agenda item (2021-22BWG) to allow for a year-end 2022 effective date. This item was exposed with a shortened comment period ending May 6.

Interested parties appreciate the opportunity to provide additional comments for this item regarding Related Party Reporting (the "Related Party Exposure"), which was re-exposed by the Working Group (the "SAPWG") on April 4, 2022.

As stated in our original comment letter on this item, we understand that one of the goals of the proposal is to identify investments that are originated, managed, sponsored, or serviced by an affiliate or related party of the insurer (referred to as managed by affiliates for the remainder of this letter). Interested parties agree that this information can be useful for the regulators, but we continue to stress that it is critical to differentiate investments where there is direct credit exposure to an affiliate from those investments that are only managed by affiliates with no underlying credit exposure to the affiliate of the insurer.

In addition to the above, we have the following additional comments on the re-exposure:

1. ***SSAP No. 25 -*** The Related Party Exposure is proposing to add the paragraph below, which would require a look through of affiliated investment structures to identify entities over which the insurer may have indirect control. To address Interested Parties' comments, the Working Group has added the footnote in red below to clarify that the look-through requirement is not required for SEC-registered mutual funds and ETFs.

   "For entities not controlled by voting interests, such as limited partnerships, trusts and other special purpose entities, control may be held by a general partner, servicer, or by other arrangements. The ability of the reporting entity or its affiliates to direct the management and policies of an entity through such arrangements shall constitute control as defined in paragraph 6. Additionally, a reporting entity or its affiliates may have indirect control of other entities through such arrangements. For example, if a limited partnership were to be controlled by an affiliated general partner, and that limited partnership held greater than 10% of the voting interests of another company (FN10), indirect control shall be presumed to exist. If direct or indirect control exists, whether through voting securities, contracts, common management or otherwise, the arrangement is considered affiliated under paragraph 5. Consistent with paragraph 8, a disclaimer of affiliation does not eliminate a "related party" distinction or disclosure requirements for material transactions pursuant to SSAP No. 25."

   FN10 Consistent with SSAP No. 97, footnote 1, investments in an exchange traded fund (ETF) or a mutual fund (as defined by the SEC) does not reflect ownership in an underlying entity, regardless of the ownership percentage the reporting entity (or the holding company group) has of the ETF or mutual fund unless ownership of the ETF actually results in "control" with the power to direct or cause the direction of management of an underlying company. ETFs and mutual funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws.

   Interested parties' comments on the amendments are as follows:

   - We agree that the look-through requirement should not extend to SEC registered mutual funds and ETFs as those investments are subject to many regulatory requirements. However, the exemption should also extend to foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction, which are within the scope of SSAP No. 30 - *Unaffiliated Common Stock* and which are very similar to open-end mutual funds in the United States.

   - As stated on our previous comment letter, doing a look-through of the underlying investments of investment funds managed by affiliates to determine if there is indirect control will be a significant operational change as information will need to be requested from affiliated funds regarding their underlying investments along with percentage ownership. Once the information is obtained, insurers will need to go through each investment where the affiliated fund owns more than 10% of the equity of another company to document whether the presumption of control is

overcome or not. We kindly request again for a 2023 implementation date to be considered.

- Interested parties would like to confirm our understanding of the look through proposal. We believe an insurer would be required to look through to the underlying investments only in the situation where the entity (managed by an affiliate) in which the insurer owns equity instruments (e.g., private equity funds and CFOs). For example, if the insurer owns debt tranches of a CFO managed by an affiliate, we assume the look through analysis would be applied since the underlying investments of the CFO are equities. However, if the insurer owns an interest (debt or equity) in a CLO investment where the underlying assets are loans, we would not expect the look through to be applied since the CLO loans do not usually give an investor any control. As the look through paragraph is being inserted into SSAP 25 (which applies to all types of instruments), we believe clarification may be needed.

- We also suggest adding the new footnote that was added to the new proposed paragraph 9 of SSAP No. 25 to the new codes being proposed to the investment schedules so that there is consistency regarding the types of assets for which the insurer would have to do a look-through of underlying investments of an affiliated fund.

2. ***Proposed changes to SSAP No. 43R to clarify that investments managed by affiliates are viewed as affiliated even if the underlying assets in the structure do not have any credit exposure to an affiliate*** – As stated above and in our previous comment letter, many insurers own asset management subsidiaries which manage securitization transactions. There is no question that the asset manager itself is a Subsidiary, Controlled and Affiliate (SCA) of the insurer and such asset managers are reported on Schedule Y as affiliates of the insurer and in the related party disclosures. However, when any debt tranches purchased from those securitization vehicles do not have any credit exposure to SCAs of the insurer, the debt tranches are not reported in the affiliated section of Schedule D and not filed as affiliated debt investments with the Securities Valuation Office (SVO) since they do not have affiliated credit risk exposure, even if the securitization vehicle is managed by a related party.

   It is very important to interested parties that this distinction is understood for Schedule D bond investments. Schedule D bond investments should not be reported in the affiliated section of Schedule D if they do not have affiliated credit exposure. We believe that the new codes that are being proposed should provide the regulators with information regarding investments that have credit risk exposure to affiliates versus those investments that are only managed by affiliates or other related parties. If the intent is to change how investments are actually reported between affiliated and non-affiliated lines in the schedules, additional changes would need to be made to the current guidance, including the annual statement instructions and the SVO Purposes and Procedures (P&P) Manual, so that this is clear to all insurers. If all unaffiliated investments which are managed by

an affiliate were required to be reported as affiliated, updates would have to be made to the SVO P&P manual to clarify that those investments continue to be Filing Exempt since the SVO does not provide designations on asset-backed securities and the manual requires filing for all affiliated debt investments. Furthermore, our understanding of the definition of affiliates and control under the Holding Company act is that they are based on voting rights of an equity holder. Therefore, asset managers that that meet the definition of affiliates under the Holding Company Act are reported as affiliates on Schedule Y and any agreements with those affiliates are reported in the related party disclosure. However, investments that are simply managed by such affiliate with no credit risk exposure to an affiliate and where the underlying borrowers are not affiliates, would not meet the definition of an affiliate under the Holding Company Act.

All the language included in the exposure with the exception of the last sentence in the new paragraph 6b being proposed in SSAP No.43R support the view that unaffiliated investments managed by an affiliate shall be reported as unaffiliated. The last sentence in 6b indicates that "any arrangement that results in direct or indirect control, including control through a servicer" should be considered affiliated. While this statement is meant to make it clear, it is confusing as it relates to unaffiliated investments (where the insurer has no credit risk exposure to the underlying borrower), that are managed by an affiliate (either a subsidiary of the insurer or an entity under common control with the insurer). Interested parties request that the final sentence be removed as this sentence will only add confusion and will create inconsistency in reporting depending on how each insurer interprets these rules. As stated throughout the letter, the presence of certain arrangements such as an affiliated servicer do not usually mean that the investments managed are affiliated. A determination of direct or indirect control over the ultimate obligor pursuant to SSAP No. 25 is still required.

b. A loan-backed or structured security may involve a relationship with a related party but not be considered an affiliated investment. This may be because the relationship does not result in direct or indirect control of the issuer or because there is an approved disclaimer of control or affiliation. Regardless of whether investments involving a related party relationship are captured in the affiliated investment reporting lines, these securities shall be identified as related party investments in the investment schedules. Examples of related party relationships would include involvement of a related party in sponsoring or originating the loan-backed or structured security or any type of underlying servicing arrangement. ~~For the avoidance of doubt, investments from any arrangement that results in direct or indirect control, including control through a servicer or other controlling arrangement, shall be reported as affiliated in accordance with SSAP No. 25—Affiliates and Other Related Parties.~~

As stated above, we are more than happy to provide the transparency that the regulators are looking for, which we believe will be accomplished through the new codes that will flag these investments as being managed by related parties.

3. ***Proposed annual statement changes to add a new electronic-only column to the investment schedules to identify investments involving related parties*** –The new codes being proposed in the related party exposure are as follows:

   1. Direct loan or direct investment (excluding securitizations) in a related party, for which the related party represents a direct credit exposure.

   2. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which 50% or more of the underlying collateral represents investments in or direct credit exposure to related parties.

   3. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which less than 50% (including 0%) of the underlying collateral represents investments in or direct credit exposure to related parties.

   4. Securitization or similar investment vehicles such as mutual funds, limited partnerships, and limited liability companies in which the structure reflects an in-substance related party transaction but does not involve a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role.

   5. The investment is identified as related party, but the role of the related party represents a different arrangement than the options provided in choices 1-4.

Interested parties offer the following additional comments on the proposed codes:

- We understand that the codes will be required on all investment schedules. However, most of the codes appear to be more applicable to Schedule D and Schedule BA investments where investments can be made through an investment vehicle. For example, when we think of the relevancy of the codes to the mortgage loan schedule, it would appear that the only code that may potentially apply is code No. 1 if the insurer has issued a mortgage loan to a related party. Codes 2-5 do not seem applicable since mortgage loans reported on Schedule B can only be reported on Schedule B if the insurer has issued the mortgage loan directly to a borrower. The same would likely be true for Schedule DB.

- It is unclear to interested parties what "in-substance" related party transactions are referred to in code 4. Perhaps some examples can be provided as to the types of

structures this is referring to so that insurers know what to report under this category.

- When reviewing the Blanks exposure on this item, we noted that the Blanks exposure added an additional code 6 for investments that have no related party relationship. We question the need for such code as a significant majority of insurers' investments will probably be coded as such. There are other columns that are populated only if the code applies to that investment (e.g., Column 3 – Code; Column 5 – Bond Characteristics). Perhaps leaving the code blank will accomplish the same objective.

* * *

Thank you for considering interested parties' comments. If you have any questions in the interim, please do not hesitate to contact us.

Sincerely,

D. Keith Bell Rose Albrizio

cc: NAIC staff
Interested parties